Current Topics in Debt Management

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HISTORIC
FRANKLIN
TENNESSEE

GOVERNMENT FINANCE OFFICERS ASSOCIATION

Session Code #1

The **City of** _____ is the county seat of **Hamilton County**.

_____ is Tennessee's fourth-largest city and located along the Tennessee River bordering Georgia.

The city was established by the General Assembly in 1839.

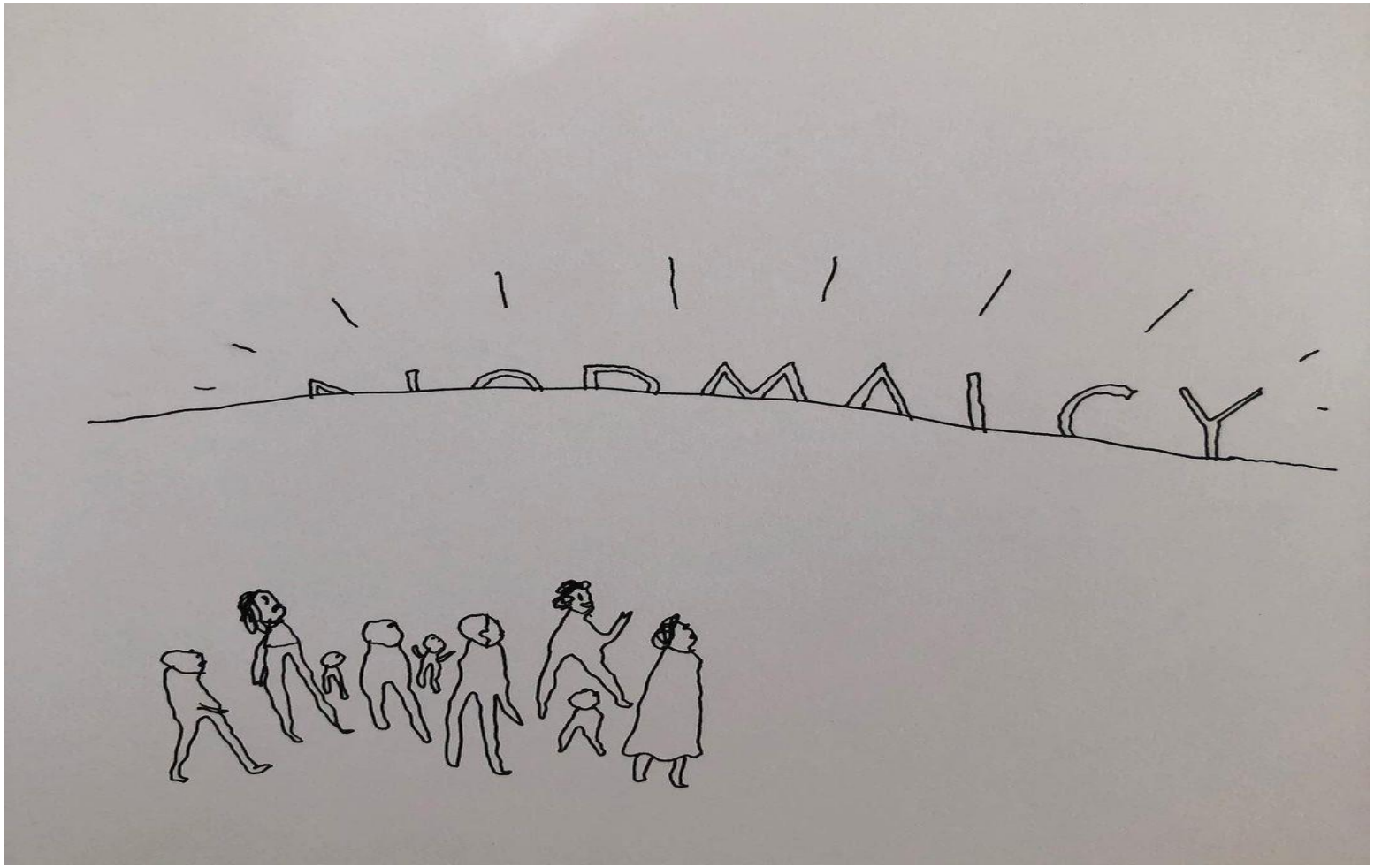
In 1870 the county seat moved from the Town of Harrison to _____.

The city's name comes from the Creek Indian word for "rock coming to a point" – referring to Lookout Mountain.

Code- _____

Greetings from the City of Franklin and Harlinsdale Farm Park

2021 in the Life of the Public Finance Officer



2021 in the Life of the Public Finance Officer

"Are you talking about the new normal of an hour ago, or is there a new new normal right now?"

Debt Update- Spring 2021

- The End of LIBOR is Still Near….but not as close as feared
- Refundings
- Tax Credit Bonds
- Pension Obligation Bonds
- ESG (Environmental, Social and Governance Risks)

The End of LIBOR is Still Near…But Will Hang on for a Little While Longer

What is LIBOR?

- The London Interbank Offered Rate ("LIBOR"), established in 1986, is a globally accepted benchmark interest rate. It is intended to reflect the rate at which major banks lend money to one another. United States municipal market has generally accepted LIBOR as a benchmark rate for many years.

- In 2017, the British Government announced it would stop publishing the LIBOR rate as of December 31, 2021. All forms of debt that use this benchmark will need to transition to a different benchmark or refinance into fixed rate debt.

- Examples of governmental debt that may be benchmarked to LIBOR:
  - Interest Rate Swap Agreements with underlying Variable Rate Demand Notes
  - Variable Rate Bank Loans
  - May Apply to Tax Exempt and Taxable Debt

Latest News

- November 30, 2020- Announcement that two LIBOR indices (1-week and 2-month) will cease publication as planned on 12/31/2021. All other indices are extended through June 30, 2023.

- Federal Reserve applauded the delay stating that "most legacy LIBOR contracts to mature before LIBOR experiences disruptions." Not a true statement for many governmental agreements, which tend to be longer in duration than private sector loans.

- Takeaway- The end of the LIBOR benchmark for most of its settings has been given an 18 month reprieve. But the end of LIBOR was delayed. Change is still coming.

What Will Replace LIBOR?

- Two U.S. Developed Indices are Available
  - SIFMA- Securities Industry & Financial Markets Association
  - SOFR- Secured Overnight Financing Rate published by Federal Reserve
- How Do They Compare to LIBOR?
  - LIBOR is a survey of bank rates combined with bank oversight and judgment
  - SIFMA/SOFR are based upon actual transactions
  - More Volatility in SOFR/SIFMA when compared to LIBOR
  - In a review of 3 years of rates, the difference in average rate to LIBOR is 9 bp for SOFR and 32 bp for SIFMA.
  - However, the difference in Maximum Rate is much higher. For SIFMA, the spread was 268 bp and 273 for SOFR.
  - The rate differential between LIBOR and the successor indices is described as Basis Risk, and may impact amount of interest paid as well as cash flow requirements for interest payments.

Role of Finance Officer During LIBOR Transition Period

Transition Existing Debt Away From LIBOR

- Variable Rate Demand Notes
  - Refinance into traditional fixed rate debt or stay variable and transition to a successor indices
- Derivitive Hedge Agreements
  - Terminate in accordance with agreements or transition to successor variable rate indices. Consider refinancing as traditional fixed rate debt.
- Bank Loans
  - Transition to successor variable rate indices or consider refinancing alternatives.
- If staying in variable rate mode, calculate the difference in current interest payments under LIBOR versus the new indices during the same period of time. Look for potential changes in interest expense and/or cash flow requirements.

Additional Considerations

1. For new bank loans issued during transition period, be aware that some lenders are proposing new agreements that use LIBOR. Be cautious if maturity is after June 2023.
2. Transitioning to a successor variable rate indices may require posting a notification on the Electronic Municipal Market Access system, referred to as EMMA. Consult with bond counsel in this area. EMMA is found at www.emma.msrb.com.
3. GASB Statement No. 93 (Replacement of Interbank Offered Rates) is applicable. Consult with external auditors for implementation. The full statement is located at www.gasb.org.

Topic Resources

- SEC Statement from January 8, 2021- https://www.sec.gov/municipal/oms-staff-statement-libor-transition-municipal-securities-market.

- GFOA Issuer FAQ for LIBOR Transition- https://www.gfoa.org/libor-faq.

- GFOA Background on LIBOR and SOFR- https://gfoaorg.cdn.prismic.io/gfoaorg/ed4901d3-13d5-42b7-9c21-bb8eeb53849a_GFR101934.pdf.

- GFOA Statement on End of LIBOR and Continuing Disclosure- https://www.gfoa.org/materials/understanding-your-continuing-disclosure-responsibilities.

Session Code #2

The **City of** _____ is the county seat of **Williamson County**.

_____ is the 7th largest city in Tennessee and one of the fastest growing.

It was founded in 1799 and became the county seat in 1800.

The city was named after Benjamin Franklin, a close friend of Dr. Hugh Williamson, a member of the Continental Congress for whom Williamson County was named.

Code= _____

REFUNDINGS

Advance Refundings

Advance Refunding of Tax Exempt Bonds- When a bond is issued to refund another bond more than 90 days before the redemption date (call date) of the refunded bond. (IRS Section 149(d)).

- Pre 1986 Tax Reform- Unlimited # of Advance Refundings
- 1986-2017- Allowed 1 Advance Refunding per issuance
- Tax Cuts and Jobs Act of 2017- Eliminated tax exempt advance refunding bonds
- July 1, 2020- Bipartisan LOCAL Infrastructure Act introduced which would amend federal tax code to restore advance refundings. Sponsored by Republican Senator from Mississippi and Democrat Senator from Michigan.

Taxable Refundings of Tax Exempt Bonds

- The market experienced significant volume of taxable refundings of tax exempt bonds in 2020.
- Between January and November of 2020, 30% of all the municipal bonds issued were taxable, and double the amount of the same period in 2019.
- Interest rate savings was available due to historic lows in taxable rates when compared to tax exempt rates issued in prior periods.
- Taxable rates for new projects are also attractive in low rate environments to private activity bonds that do not qualify for tax exempt financing.

Current Refundings

Current Refunding of Tax Exempt Bonds- When a bond is issued to refund another bond less than 90 days before the redemption date (call date) of the refunded bond. (IRS Section 150).

- **Still allowable without limitation.**
- For variable rate demand notes that are callable with short notice provisions, the current refunding option is still available.

Plan of Refunding

TN Code 9-21-1003-*Prior to the adoption by the governing body of the resolution authorizing the issuance of refunding bonds, a plan of refunding shall be submitted for review to the Comptroller of the Treasury….*

Available Resources:

1. Municipal Advisor
2. MTAS/CTAS
3. Your Financial Analyst with the TN Comptroller Office of Local Government Finance-

https://comptroller.tn.gov/office-functions/lgf/debt/contacts.html.

TAX CREDIT BONDS

Definition of Tax Credit Bonds

Four Qualified Tax Credit Bonds were enacted in tax legislation in years 2008, 2009 and 2010 for specific tax-exempt purposes. Certain bonds allowed a credit to investors while others paid a direct subsidy to issuers. Intent was to reduce borrowing costs to state and local governments and encourage infrastructure investment of “shovel ready projects” during the recession of the same period.

- Examples include,
  - Build America Bonds (BABs)
  - Qualified School Construction Bonds (QSCBs)

Risks of Tax Credit Bonds (1)

- Will the federal government keep its promise to pay the full subsidy for the life of the tax credit bonds?
  - Beginning March 2013, the federal government's automatic spending cuts (Sequestration) went into effect and subsidy payments to direct pay tax credit bonds were reduced by 8.7%.
  - For FY 2021, the sequestration rate is 5.7%.

Risks of Tax Credit Bonds (2)

- Will delivery of subsidy payment ever be delayed?
  - Processing of payments has been delayed by the IRS due to multiple factors including,
    - Federal government shutdown
    - COVID 19
    - Lack of electronic processing for Forms 8038-CP.

Many issuers in various states are currently experiencing delays of many months to receive payment. Inquiries to the IRS may take months to receive return communication and resolve.

Tax Credit Bonds in 2021

- In recent years, many issuers have refunded out of tax credit bonds and into traditional fixed rate tax exempt debt, in part to reduce risks from Sequestration and IRS delays. Many refinancings also result in interest rate savings, depending upon the amount of the tax credit.

- For issuers with high federal credit amounts, refunding into tax exempt debt may be a cost to the government. If remaining in tax credit bonds, consider how you will cash flow significant delays in processing IRS payments as well as pointing out the receivable due from IRS to auditors.

- Congress has some interest in bringing back tax credit bonds as part of a new infrastructure package.

PENSION OBLIGATION BONDS

Definition of Pension Obligation Bonds

Pension Obligation Bonds (POBs) are taxable bonds that some state and local governments have issued as part of an overall strategy to fund the unfunded portion of their pension liabilities by creating debt. The strategy of POBs assumes that the bond proceeds will be invested at higher rates of return than the interest expense owed over the term of the bonds. Thus, an economy with very low taxable borrowing rates and high rates of return in the stock market are most attractive for this concept.

POBs in the News

- New York Times reported on 2/16/2021 that cities and states issued $6.1 billion of pension obligation bonds in 2020.
- GFOA recommends that state and local government do not issue POBs. https://www.gfoa.org/materials/pension-obligation-bonds.
- Tennessee statue limits new issuance of POBs. TCA 9-21-127 and 9-21-105(4)(A)
- SB0539 in the 2021 Session of the Legislature proposes to remove expired parts of the code.

ESG (Environmental, Social and Governance Risks)

Definition of ESG Risks

From GFOA- “ESG (environmental, social, and governance) refers to three key types of factors that can impact a government’s credit profile. In general, ESG factors represent areas believed to affect the long-term sustainability of a community, such as a community’s exposure to climate risk (“E”), long term demographic changes (“S”), or management of pension liabilities, among other governance issues (“G”).

https://www.gfoa.org/materials/esg-considerations-for-governmental-issuers.

ESG and TN Issuers of Debt

- Credit Rating Agency Considerations
  - Rating Agencies have a framework for assessing ESG type risks as part of the credit rating process.
- Issuer Disclosure Considerations
  - Does your government have risk factors that materially impact credit quality and should be disclosed in offering documents or EMMA, or both?
- Investor Considerations
  - Would an investor decide not to purchase bonds of an issuer with significant risks?
  - Socially Responsible Investing- Investors who are looking for specific projects to be funded from bonds in which they purchase?

Session Code #3

The **City of** _____ is the county seat of **Hardeman County**.

- The first town in Hardeman County was established in 1823 on the “Hatchee” river, and aptly referred to as Hatchie Town.
- Because of repeated flooding a new site was selected as the county seat.
- The new site was named _____ in honor of the South American Liberator Simon Bolivar.
- _____ was officially established on October 18, 1825.

Code= _____

Parting Thoughts for Finance Officers in 2021

If your actions inspire others to dream more, learn more, do more and become more, you are a leader.- John Quincy Adams

What you do has far greater impact than what you say.- Stephen Covey

THANK YOU FOR BEING PART OF OUR VIRTUAL CONFERENCE!

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